

Remittance Flows for Development: Policy Options

Introduction

Remittances, the earnings sent by migrants to their countries of origin, have been used as a means of supporting families back home for decades. Until recently, however, governments, development agencies, economists and other researchers have shown little interest in the role of remittances in economic development; most argued that remittances were used for consumption, not productive investment. This has begun to change, largely for two reasons. First, growth has been spectacular: the level of remittances has almost quadrupled in the Western Hemisphere over the past decade to approximately \$20 billion. Second, organized groups of migrants, known as Hometown Associations (HTAs) have begun to channel a portion of their resources for investment, largely to fund local infrastructure projects. While the resources of most HTAs are quite limited, collectively they are having an important impact on their communities. Governments in Latin America, most notably Mexico, have taken an active role in stimulating this process. Donors have also begun to take a harder look at the role of remittance flows for development. This paper will explore programming options to respond to this important phenomenon.

Recent Growth

As migration to the United States has increased over the past decade, the level of remittances sent back to countries in Latin America and the Caribbean (LAC) has accelerated dramatically, growing at an average rate of between 7–10% per year across the region in recent years. Estimates indicate that the total volume of remittances to LAC exceeds \$18 billion per year. A country breakout is provided in the table below. Many experts believe that the available statistics seriously underestimate the real volume of transfers, which may be as high as \$20 billion. Official figures are unreliable for a number of reasons; most importantly, they are based on central bank figures and do not accurately capture informal flows. (The figures below are based on IDB estimates, from all sources, including the U.S. The countries listed represent over 90% of total volume.)

Family Remittances to LAC

Year	1999
Mexico	\$6.795 billion
Brazil	\$1.898 billion
Dominican Republic	\$1.747 billion
El Salvador	\$1.580 billion
Ecuador	\$1.247 billion
Peru	\$819 million
Cuba	\$800 million
Jamaica	\$781 million
Haiti	\$720 million
Colombia	\$612 million
Guatemala	\$535 million
Honduras	\$368 million
Nicaragua	\$345 million
All Countries	\$18.247 billion

In fact, remittances are having an economic and social impact far beyond their traditional role as a supplement to family income. In LAC, they now constitute a critical flow of foreign currency in the majority of countries, as the following data illustrate.

The value of remittances:

- Exceeds Official Development Assistance inflows;
- Is equal to nearly one-third of total regional Foreign Direct Investment;
- Accounts for over 10% of GDP in Haiti, Nicaragua, El Salvador, Jamaica, the Dominican Republic, and Ecuador;
- In Mexico, remittances equal revenue from tourism and exceed 160% of agricultural exports;
- In El Salvador, remittances are seven times total FDI;
- In Guatemala, remittances are now nearly equal to coffee exports.

The implications of these flows are still not well understood. More recent research suggests that the traditional view that remittances do not have a positive impact on growth fails to grasp a far more complicated picture. In this view, the indirect effects of consumer spending by receiving families and a small but still significant amount of productive investment are seen as important contributors to migrant-sending economies. A detailed exploration of the merits of this argument is beyond the scope of this paper. However, it should be clear from the statistics above that remittances are a major macroeconomic force, on par in some countries with agriculture and other sectors that have been the principal focus of international donor efforts for decades.

Transaction Costs

Traditionally, remittances have been delivered by hand by migrants or a third party, or sent by money transfer companies, like Western Union. Other non-bank financial institutions also offer similar services, with money orders playing a smaller but still significant role. Transaction costs have historically been quite high. The combination of fees and unfavorable exchange rates used by transmission companies can bring the total cost to over 20 percent. If estimates of the total flow of remittances are accurate, then total fees generated could reach \$4 billion per year. If these estimates are accurate, then a drop in fees to 15% would result in an additional \$1 billion flowing to the region's poor.

High fees, as well as concern over fraud in the banking sector and postal system, explain why many migrants continue to use informal systems. It is unclear how much money is being sent back through informal means: estimates range from as little as 10% to as high as 46% of remittance flows in some communities. Whatever the actual figure, informal transfers remain an important avenue for remitting funds.

New Players in the Remittance Market

In the past decade, the remittance market has expanded extraordinarily -- the international segment of the U.S. money transmission market grew at 20% per year from 1991 to 1996. Attracted by this growth, new players, including private transfer companies, banks, and credit unions, have begun to offer services. As a result, the market is becoming more competitive. There is evidence that the cost of transferring funds has begun to drop.

The entrance of banks and credit unions is particularly significant, for several reasons. First (this point applies to banks only), unlike non-bank financial institutions, they are formal financial institutions, so the flow of funds can be measured more accurately by central banks. Second, the fees charged are far lower, with banks charging 10% on average and credit unions under 7%. Third and most importantly, the funds they capture have the potential to enter the financial sector in the form of savings which can be multiplied many times throughout the economy.

Hometown Associations

Hometown Associations (HTAs) are groups of migrants organized in the United States around their common community of origin. The earliest HTAs were formed in the 1960s. They became more widespread with the increase in migration that began in the 1980s and accelerated in the 1990s. While the total number of HTAs is not known, it is undoubtedly quite large -- there are 170 HTAs registered with the Mexican consulate in Los Angeles alone.

HTAs are at various stages of development. Some communities are just beginning to organize themselves, while others have formed local and in some cases national federations, for example the HTAs from the Mexican state of Zacatecas. Most are originally organized for social purposes, to preserve cultural values and ties. As they evolve, they often begin to raise funds for charitable purposes (some are organized around specific charitable ends). The more organized groups play an important role in their home regions. According to one report, the Zacatecan HTAs contributed \$600,000 for 56 community projects in 1995. The Mexican government has taken the lead in reaching out to HTAs, and has played an important role in fostering their development in the U.S. These efforts, which began in the Salinas administration, have taken on greater visibility in the government of President Fox.

Funds raised by HTAs are used almost exclusively for local infrastructure or social projects — roads, bridges, parks, churches, schools, health clinics, and ambulances. Parallel to their outreach to HTAs in the U.S., governments have designed programs to support local HTA investments. Again the Government of Mexico is furthest along, with the lead having been taken by state governments. Perhaps the most prominent of these programs is the state of Zacatecas' "Tres Por Uno", in which HTA funds are matched with national, state and local funds. Other Governments in LAC have also begun to support HTA and other migrant investments.

Some HTAs have begun to explore investing to generate employment in their villages, but most of these efforts are beginning. Governments are supporting these efforts, with matching funds and credit programs. Many of these programs are targeted at wealthier individual migrant investors. For example, the government of the Mexican State of Guanajuato has encouraged investment in several maquila plants. Interestingly, while many HTAs express interest in seeking support from their government, they also express distrust of government efforts.

Other Donors

Despite their increasing importance, the role of remittances has only recently captured the attention of policymakers. This spring, the InterAmerican Development Bank's Multilateral Investment Fund (IDB/MIF) sponsored a conference entitled "Remittances as a Development Tool." Among the many topics of debate, two important areas for attention emerged: the onset of competition in the market for remittances, and the potential value of remittances for productive investment. The Inter-American Foundation (IAF) also sponsored a conference last spring. The following is a brief summary of other donor activities to date.

Inter-American Foundation

The IAF has been working on remittance-related programs for quite some time. They have supported grassroots efforts with HTAs as well as programs with credit unions and other microfinance institutions (MFIs), in Mexico, Haiti, and the Dominican Republic. Many of these activities are quite innovative, as illustrated by the following two examples. In Haiti, the IAF is supporting Fonkose, Haiti's Alternative Bank for the Organized Poor, which is an NGO that is planning to spin off its financial services to form a bank. Fonkose has established a link with US Bank to provide lower-cost remittance services. A second program works with the Haitian Development Bank, a private bank owned by cooperatives and credit unions. The program is a partnership between banks and credit unions. They are working to set up an electronic transfer system, based on a fee-sharing arrangement that will take advantage of the extensive rural branch network of the credit unions.

Other Foundations

There are several other foundations looking at remittances, including Ford, MacArthur, and Kellogg. However, most of their efforts are focused on research, reflecting the nascent stage of most remittance support programs. MacArthur, for example, is looking at how HTAs manage productive investments and the efficacy of state support for such projects. Ford is the exception; they are doing a pilot program with a microbank in Oaxaca. These research efforts are important, and they have excellent links to universities (e.g., UCLA) that are conducting some of the most advanced work. Very few foundation programs are operational in the way that donors use that term, but they are doing critical work on the efficacy of government support for HTAs, the HTAs themselves, and the macroeconomic impacts of remittances.

Inter-American Dialogue

IAD has taken the lead in moving the policy debate on remittances forward. Their work in this area has evolved from USAID support to IAD under the Central American 2020 project, which looked at a range of issues affecting the region, including migration and remittances. IAD is working with the MIF to document best practices in creating enabling environments that encourage lower transaction costs. They have also expressed interest in doing a similar best practices study on HTAs.

InterAmerican Development Bank/Multilateral Investment Fund

Within the IDB, the MIF is working to analyze remittances and develop pilot projects. They are planning to target three areas: lowering transaction costs, supporting HTAs, and building public/private partnerships. In the first area, they are developing pilots with credit unions and MFIs to provide lower-cost remittance services. Much of this entails capacity building to develop the systems necessary to handle transactions, which builds on earlier work to strengthen microfinance organizations. In the second, they will support two projects in Mexico, with Nafin (Nacional Financiera, a state development bank) and a leading NGO, the Fundacion para la Productividad en el Campo, to provide financing and technical assistance. In the last area, they are exploring public/private partnerships to look at more macro issues, including bank fees and tax incentives for migrant investment.

Policy Options

Before laying out policy options, it is important to begin with a note of caution. It is tempting to look at the massive amounts of money being remitted and forget what they are: money sent by the most poorly-paid of America's workers back to relatives who are poorer still. These funds should not be viewed as a boon to development agencies simply because they dwarf our assistance levels. Whatever one thinks of the moral argument, the practical one is far more compelling. The vast majority of these funds are meant to support livelihoods, in a market in which informal means play a critical role. Government and donor programs that fail to recognize and meet people's needs will lose their support and thus the funding that makes them possible in the first place. So what can be done? Plenty, as long as we recognize the constraints, and the fact that there is much to be learned in this rapidly-evolving field. The following recommendations are based on a review of available literature as well as extensive conversations with other donors and policymakers.

Policy Dialogue

Given how little is known about remittances and the role of HTAs as development agents, it is critical that we continue to educate ourselves. We should track ongoing research that will shed important light on what works, both for government-supported programs and HTA efforts. We should also actively engage with other donors to avoid duplicating efforts. To that end, USAID should establish a working group in collaboration with donors, foundations, universities, and host governments. The IDB is tentatively planning an event in January or February to launch a series of pilot programs, and has invited USAID to participate. This could serve as a vehicle to pursue the establishment of an ongoing policy dialogue. Since this is an area that USAID is just beginning to engage in, this dialogue could also serve to raise the profile of the issue within the Agency.

Hometown Associations

USAID should support communities' efforts to look for opportunities for productive investments. There is work being done at the grassroots level by IAF, an effort we should not attempt to duplicate. Rather, our programs should track more closely with those of the MIF, in that they should focus on working with intermediate agents at a broader level, including the private sector, NGOs, and local, state and national governments. The challenge here is to provide services that HTAs are lacking. Effectively diagnosing these needs is a critical area for further research, so USAID efforts must build on this research to determine what works. Many HTAs, despite impressive organizations in the U.S., lack effective counterpart organizations in their home communities, and thus well defined projects for investment. Thus, one of the most pressing needs of HTAs is for technical assistance for in-country project development. USAID has vast experience in providing such technical assistance for project design and implementation.

In addition to the lack of organizational capacity in home countries, one of the great challenges facing USAID in its work with HTAs is a structural one: much of the necessary work is in the United States, in terms of capacity building, community outreach, marketing services. One way to solve this problem might be through effective partnering with an organization that is domestically based or focussed. Potential partners might include a U.S. bank such as Wells Fargo, or the World Council of Credit Unions, both of which have shown some interest in serving the migrant market. Such a partnership would also need to include a non-profit organization or other entity with experience working with migrant populations. This sort of public-private partnership might serve as a model for the Global Development Alliance (GDA).

Formal Financial Institutions

As noted above, the MIF is developing pilot projects in an attempt to lower transaction fees, by encouraging competition from formal financial institutions, and quasi-formal institutions like credit unions and MFIs. There are many challenges involved in working in this area. Although banks are entering the market, few have the network or retail outlets that would make their services convenient for

rural populations. More importantly, both banks and MFIs would have to work hard to build trust in communities that have little experience with the formal banking sector. USAID could build on its successful experience in microfinance to encourage commercially oriented MFIs to enter this market, an approach similar to that of the MIF. This is especially true for programs that have strong links to banks and other regulated entities, including El Salvador, Bolivia, and the Dominican Republic. Many of these institutions have more extensive networks in rural areas, and have extensive experience in marketing their services to poorer clients. One promising approach was noted above with the IAF's experience in Haiti: creating partnerships between banks and credit unions or MFIs, to build on the comparative strengths of both. This is an area in which USAID's Development Credit Authority (DCA) might play a valuable role in encouraging banks to take on new business opportunities. This also might serve as a GDA partnership.

There may also be opportunities to link work with hometown associations and formal financial institutions. According to some research, HTAs are quite reluctant to use formal mechanisms to remit funds. This may seem ironic given their own organizational capacity, but in fact it derives from frequent bad experiences involving high fees and poor service. This represents a significant obstacle that will need to be overcome. As models evolve which demonstrate cheaper and more efficient services, especially in rural areas, HTAs may begin to develop trust in these institutions. HTAs represent important potential clients for these formal financial institutions, both as a source of new business and an avenue for marketing outreach to their members and relatives. As HTAs begin to recognize this, they may begin to leverage this power for better services, including new branches, more credit, and better terms. This in turn would serve to reinforce the process of formalization of the sector, driving down costs and expanding the multiplier effect.

Next Steps

1. Coordination with IDB/MIF

USAID has been invited by the IDB/MIF to participate in their upcoming event on remittances, tentatively scheduled for January/February 2002. The scope of the event, and our engagement in it, has yet to be defined. USAID might use this opportunity to create a working group on remittances. As noted above, this working group would be comprised of donors, private foundations, and universities interested in the issues. It might also include representatives of host country governments. The purpose of this effort would be to share results of research and pilot projects, avoid duplication of effort, and to form a common agenda on remittances. USAID might also want to encourage the attendance of Mission staff and representatives from some of our key partners.

In addition, the MIF will be hosting a series of country roundtables in which they have invited USAID to participate. They are tentatively scheduled for early February 2002, in the Dominican Republic, El Salvador, Jamaica, and Mexico. This would be an excellent opportunity to build relationships in the field.

2. Internal Dialogue

This paper will be shared with LAC field Missions and other USAID staff for comments. LAC/RSD is particularly interested in getting Mission feedback in the following areas: 1) the degree of Mission awareness and interest in remittance activities; 2) host government and other efforts to promote appropriate policies and/or build institutional capacity to reduce transaction costs; 3) host government and other efforts to support HTAs or other migrant investment; and 4) on the kinds of support would be most useful from the field perspective.

3. Best Practices Study

Given how little is still known about remittances, both in terms of their macroeconomic impact and their potential as a source of investment for development, it will be important to proceed carefully. As noted above, the MIF is working with the Inter-American Dialogue to document best practices for enabling environments. One promising option would be to support a similar effort to document best practices in support of HTAs, with the IAD or another research institute. The results of both efforts could then be used as a platform for pilot activities.

4. Pilot Activities

LAC/RSD is beginning to explore options to support select pilot activities. We are considering the issuance of a flexible RFA to invite proposals that would work on transaction costs and HTAs. This effort would be based on lessons learned from our consultations with donors and other partners, as well as best practices research. Ideally, the pilot activities would involve close coordination between LAC/RSD and LAC Missions. Successful pilot activities could be expanded into broader programs, other countries and regions, or possibly into a Global Development Alliance partnership.

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